A REVIEW OF THE PROPOSED NATIONAL RESERVE BANK[1]

What are the true functions of the proposed national reserve bank? Let us first reason together as to what our true condition is. I assert from world-wide comparisons that the independent national-banking system is the best the world has ever known. Many state banking systems now well regulated are also good. But practically everyone admits that our currency issues are excessive and rigid. They expand but do not contract. There is no large cash reservoir where relief can be had in the day of trouble, that will automatically refill again when trouble ceases, to be ready for relief in the next emergency. The thing lacking therefore is some method to provide in the day of distress when confidence is shaken, extra cash which will prevent the cash suspension by banks generally, and which will prevent the stoppage of the wheels of commerce, resulting in general stagnation of trade and industry. We want relief in abnormal periods, but not further inflation or overexpansion of credit in normal times. The great problem is, how can this boon best be effected?

In my judgment the progressive world has solved the problem in keeping one great central reservoir of cash, where relief can be had in the day of trouble, instead of scattered reserves as under our system. In our case every bank holds to its own reserves and would do so if enlarged, because self-preservation is the first law of nature. Panics are bred, not in the country but in great cities, where colossal promotions flourish. When confidence is shaken by some great failure, small depositors become frightened and demand cash, thus lowering scattered reserves. If these depositors knew there was a great reservoir of cash where solvent banks could get rediscounts for cash in order to replenish their reserves, it would have a marvelously favorable effect, because of the mere knowledge

[1] Remarks in discussion before the Western Economic Society, Chicago, November 11, 1911.

that "you got 'em, I no want 'em; you no got 'em, I want 'em." I speak from practical experience and not from theory.

During panics in Britain in 1847-57 and 1866, the Bank of England, when cash payments were generally suspended, through its issue department opened up its floodgates of extra cash; the governor sent word to the street that all good solvent banks and merchants would be accommodated, and history records that in the twinkling of an eye the panics were stayed. But it is to be noticed that the extra cash issued and the increased loans granted were soon retired to prevent a redundancy of currency issues and abnormal credit expansion.

Contrast these relief measures with the calamitous results of cash suspension of banks in New York City in 1907, and the flashing by wire to the country generally that no cash would be paid on balances, thus compelling general cash suspension by banks throughout the country.

I assert that if we had had a great central reserve of cash, where solvent New York City banks could have obtained rediscounts for cash, general suspension would not have occurred. Further, the plunging banks there could have been refused assistance, and thus weeded out. The country generally could have gone on the even tenor of its way, and the trouble would have been localized in New York City. That maxim, promulgated in the celebrated bullion report of 1810 to the House of Commons, to wit: "In the presence of a panic it is the duty of the bank to discount freely for all solvent parties," is the keynote to restore confidence.

Another effective maxim might be added, to wit: Contraction must follow to the end that the reservoir may refill ready for the next emergency.

The vital question then is: Would the proposed National Reserve Bank accomplish these great ends?

In my judgment, as to capital; stockholders, including state banks and trust companies; earnings and dividends; executive officers, directors, and methods of electing; deposits; disposition of United States bonds; general loaning functions for relief measures, as enumerated in paragraphs 38 to 42 of the revised plan—in most material respects, yes. But as to the loaning functions of the

local associations; acceptance privileges to all national banks; unnecessary branches; reserves of the National Reserve Association; and easy methods of note issues—in most respects, no.

As to the loaning functions of the local associations, permit the following diagnosis:

With reference to the several methods of obtaining rediscounts by member banks at the National Reserve Bank, even Mr. George M. Reynolds openly said in an address before the Texas State Bankers' Association: "To my mind these provisions for the extension of credit are ample to meet all the reasonable requirements of business." I think there is not a shadow of doubt that these facilities would prevent cash suspension by banks in the United States. If so, then of what use are hundreds of separate local associations of banks with not less than $5,000,000 combined capital and surplus, with a board of directors (number not stated) presumably from different sections, in constant attendance to pass on and guarantee paper, not necessarily with collateral, offered for discount at a branch of the association by members of such local associations? But it is still further provided that such banks receiving a guaranty shall pay a commisson to be fixed by the board of directors, and that in case of loss the members shall share it proportionally to capital, etc. Under such conditions, where capital is at all abundant and where banks can obtain rediscounts with their city correspondents, or with the reserve bank, as heretofore stated, would not these many boards be practically useless? Under normal conditions banks generally are not going to pay a commission on rediscounts, and then to stand for losses that may accrue through others' blunders or through the plunging methods of a local association board. The very banks that ought to be denied the right would be the ones to exercise it. If so, I ask in all fairness, is it practical, logical, or just to saddle losses by compulsion on the many conservative banks which never ask for such rediscounts, instead of where they belong, upon the National Reserve Bank which discounts the paper? However, as a secondary emergency measure through the city clearing-houses only, somewhat as stated in paragraphs 31–33 of the revised Aldrich currency system, the device would be practical and might possibly

be called into use. But further, subscribing banks *must* join a local association and cannot get out. I am convinced that for these reasons many conservative bankers would respectfully decline to take stock in the Reserve Bank, unless these functions are materially altered to remove objectionable features. To my mind this part of the machinery, except as it works through regular clearing-houses on lines similar to the Aldrich-Vreeland Bill, should be cut out. The proposition is unparalleled anywhere.

As to giving *all* national banks the right to accept customers' time drafts on them—even with security—I firmly believe that this is a dangerous proposition. It is brokerage, not legitimate banking. Any thought that live, legitimate paper, secured by bills of lading, etc., is not now promptly cared for under normal conditions, and will not be under abnormal, if we have a national reserve bank, is too remote for argument. Consequently the sophistical preachments that we can create a discount market by manufacturing additional liquid paper with which to employ idle funds, to any thoughtful mind seems amazing. I assert, additional legitimate liquid paper can only come from our enlarged trade and commerce. We must not forget that it is relief in the day of trouble we seek, not further expansion of our credit in normal times. Therefore let us ponder these pertinent questions.

With 15,000 millions of dollars of deposits in the banks of the United States; with a monumental pyramid of credit-expansion; with opportunities for rediscounts by banks generally through their reserve correspondents not abridged in the least; with enlarged opportunities to rediscount at the National Reserve Bank, as heretofore noted; if conservatism is to be our watchword, how can we consent to allow national banks generally to loan to their limit of assets; then rediscount as heretofore noted; then loan their credit, by accepting customers' drafts on them, even if secured on the rubbery expression of "commercial paper"; then permit those customers to peddle such paper at their pleasure? The very banks that ought not to do it would be the very ones to go to the limit.

These methods simply pyramid credit on credit and such extremes are entirely unnecessary and indefensible. All economic

history teems with warnings against overexpansion of credit. I do not wish to go on record as absolutely against it. But permit the suggestion that, if acceptance privileges are to be granted to banks at all, the practice, as in London, should be confined to dealings with strong acceptance or discount houses making it their business. Picayune acceptances have no public market.

Personal inquiry as to the practice was made in a city of 40,000 in Scotland. Listen to the answer of several branch bank managers: "The system is *not* used in Scotland. They [the banks] use the ordinary system of bills (loans) or discounts, and of overdrafts, secured, but do *not* loan the credit of the bank otherwise." I assert, the campaign to carry out the idea here is greatly misleading, and to allow our banks generally to adopt this policy is, as a conservative measure, simply unthinkable.

Further, in Europe enlightening literature shows conclusively that the great bulk of the acceptances are upon drafts drawn on account of international trade with bills of lading or, to a much smaller degree, with "marketable securities" as collateral. Acceptances "without collateral" cut comparatively a small figure. When we consider that Great Britain, France, and Germany are creditor nations for probably 20,000 million dollars, portions of which sum are continually being repaid; when we consider that the foreign trade of Great Britain, France, and Germany is 10,500 millions of dollars annually, as against one-third of that amount, or 3,500 millions here; and when we consider that nearly all of this live, paid-at-maturity paper seeks the lowest international money-market rate, is it any wonder that the great European banks hold vast quantities of quick, liquid assets that, at present, in our developing state we cannot command?

Here is a part of the meat in our cocoanut. Let us bend our energies to building up an international banking business, by throwing out our emissaries to the ends of the earth; build up our merchant marine by subsidy, if necessary, as so-called free-trade nations do, that direct connections be made with foreign ports instead of largely through London; so enlarge our foreign trade that drafts accompanied by bills of lading will become plentiful; forge ahead in our successful race to become the leading creditor

nation, and show to the world that New York City, like London, is the world's market for gold at all times. Then, and not till then, shall we have the quick, liquid paper we seek. Easy methods of further internal credit-expansion would aggravate, not relieve, the disease.

That word "acceptance" has, I fear, misled many to think it has a miraculous power to oil the wheels of commerce. Let us see. A accepts a draft drawn by B, and C discounts it. That is an "acceptance." Again, B gives a note, A indorses it, and C discounts it. That is a "loan." The liability of A and B is exactly alike in both cases.

The revised Aldrich plan calls for 15 branches. Further, "the districts may be readjusted from time to time, and new districts and *new branches may be created by the directors*."

Therefore, the directors have unlimited powers to create as many branches as they see fit. Andrew Jackson, in 1836, killed the second United States Bank because it entered into competition with the other banks. His act was justifiable. I am firmly convinced that danger threatens the existing fabric of independent banks from the moment such a law is enacted. One eminent branch bank advocate lately declared he was in favor of this plan "because it was the next best thing to branch banking."

Why are fifteen or any number of branches needed? If these branches are to do much business, then they must have very expensive outfits; and able management cannot be inexpensive. If they do a large business, do they not enter into competition and tend to monopolize the present business of the reserve city banks? If they do a small business, they are expensive and useless appendages.

It does not seem to be a proper function of the National Reserve Association to take part of the cash reserves of the stockholder banks of the country, and then through its branches with that cash to enter into competition for loans with those same stockholders. It is not its mission to rediscount to any large extent for banks in normal periods, as that would simply spell monopoly, would empty the cash reservoir against the day of trouble, and would be a colossal undertaking in this vast country. Large profits are not its aim. Its true mission is to hold our reserves, to allay distress

in the day of pressure, and none other. Banks that in normal times cannot stand practically on their own resources are like pampered weaklings—useless as nation-builders.

The Waukesha National Bank keeps accounts drawing interest in Milwaukee, Chicago, and New York banks. I ask in all fairness if our bank, in normal times, needs a rediscount; and, as these regular correspondents know whether or not we are entitled to it better than any branch of the Reserve Bank can know, why should we not rediscount with them? Further, why should we deposit, with the Reserve Bank, part of our reserve cash, without interest, then dissipate that same reserve through rediscounting? The very object sought would be defeated. It is also unfair, and tends toward a monopoly that sooner or later a second Andrew Jackson will throttle. I stand for the preservation of the independent banking system of the United States, which has done wonders in upbuilding the nation, and I also stand against monopolistic branches in any form. As the United States subtreasuries are not abolished, permit them to retain sufficient cash on hand to cover probable cash transfers, as is now done for banks. When this is done the last argument for branches is gone.

If we are ever to win the world's financial center for New York, we must never allow a Reserve National Bank to hold, as reserve, anything but the world's standard gold, or equivalent gold certificates. Under the proposed plan it can hold, as reserve, 550 millions of silver and 346 millions of legal-tender paper. As the United States deposits its funds in the National Reserve Bank, and as its bonds, legal tenders, etc., are payable in gold, all obligations of the Reserve Bank should unequivocally be payable in the world's acknowledged standard, or otherwise only at the option of the holder thereof. Further, if, as proposed, we allow national banks to hold National Reserve Bank notes as reserve, will not gold according to Gresham's Law naturally flow out of the country, thus undermining the best known metallic foundation for our great superstructure of credit? We cannot too earnestly ponder this momentous question: As the Reserve Bank can issue the vast sum of $900,000,000 of untaxed notes, and $300,000,000 additional, taxed at only 1½ per cent; and, as it is

subject to a small tax of $1\frac{1}{2}$ per cent on reserves falling below 50 per cent of deposits and outstanding notes, first deducting half of the United States bonds held, clearly would not inflation and over-expansion of credit take place before any tax on deficient reserves began to operate? Moreover, there is no provision to retire the notes when the United States bonds are sold or retired. The National Reserve Bank can issue $1,200,000,000 of uncovered currency, slightly taxed. Then follows extra currency taxed at 5 per cent. Herein alone lies the desired flexibility. By contrast the Bank of England can issue only $90,000,000 untaxed, and a sovereign of gold must cover every pound note in excess thereof. The Bank of France lately averages about $1,000,000,000 of notes outstanding, with about 80 per cent of coin behind them. The Imperial Bank of Germany can issue but $112,000,000 of uncovered untaxed notes, and all in excess must pay 5 per cent per annum tax. The permissible currency, uncovered by gold, under the Aldrich plan, is probably greater than the whole uncovered currency in the twenty great central banks of all Europe combined. In a land where capital is abundant, the issuing of currency not largely covered with gold is unjustifiable. As Professor Sumner declares, it is fictitious or coined credit, and in normal times should be limited. It is justifiable in abnormal periods of stress, but must be subject to a sufficient penalty to come out as a relief measure, and then to retire when trouble ceases, if inflation and overexpansion are to be avoided. This is the crux of the whole problem.

Therefore, give us a National Reserve Bank that will not dissipate our reserves on loans, that aid may be vouchsafed in the day of trouble, and thus prevent cash suspension by banks, and the train of resulting evils. Give us a bank that under no circumstances will undermine our independent banking system, or serve to inflate either currency or credit. If this cannot be accomplished, perfect the Aldrich-Vreeland Bill, which now is sufficiently effective to accomplish this great end, without the evils herewith enumerated. The only objection to it is, it is not automatic in its operation.

ANDREW JAY FRAME

WAUKESHA, WIS.